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Supreme Court of the United States

OCTOBER TERM, 1957—No. 368

IDEAL MERCANTILE CORPORATION,

Petitioner,

against

GALLANT FABRICS CO., INC., Etc.

(Petitioning Creditors)

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Reasons for Denying the Writ

This brief is submitted on behalf of the petitioning creditors, in opposition to the petition of Ideal Mercantile Corporation, for a writ of certiorari to the United States Court of Appeals for the Second Circuit.

The petitioner has based its application for a writ of certiorari upon the following grounds:

(a) The decision of the United States Court of Appeals is in conflict with the decisions of the Supreme Court of the United States, other Circuits and District Courts and prior decisions within the Second Circuit.

(b) The questions raised are of vital importance to the business world generally, as well as in the administration of the Bankruptcy Act.

It shall be shown, hereinafter, that there is no conflict in the decisions, and that the business world will not be adversely affected by the decision of the Court of Appeals.

The cases in this Court have consistently followed the rule of law promulgated in the case of *National Bank of Commerce* v. *Downie,* 218 U. S. 345, 31 S. Ct. 89, 54 L. Ed. 165, where the Court held that a transfer of a claim against the United States is absolutely void, and said as follows:

> "They are clean-cut cases of a voluntary transfer of claims against the United States, before their allowance, in direct opposition to the statute. If any regard whatever is to be had to the intention of Congress, as manifested by its words—to clear, we think to need construction—we must hold such a transfer to be absolutely null and void, and as not, in itself, passing to the appellants any interest, present or remote, legal or equitable, in the claims transferred."

It should be noted that the claims which were assigned had not yet been paid by the United States and although the decision is not based on that fact, it is important to note for a complete understanding of the decisions which follow. The decision of the Supreme Court in this case was followed in a number of cases. Matter of *Guarantee Title & Trust Company,* 185 Fed. 373 affg. on rearg. 193 Fed. 52; *Hudford Co. of New York* (C.C.A. 2d Cir.), 257 Fed. 722. This decision was also followed by the Court of Appeals of the State of New York in the case of *Manhattan Commercial Co.* v. *Paul,* 216 N. Y. 481, 111 N. E. 76.

Approximately thirty years later this court again interpreted Section 203, Title 31, U.S.C.A., in the case of *Martin* v. *National Surety Co.,* 300 U. S. 588, 57 S. Ct. 531, 81 L. Ed. 822. The facts in this case were entirely different from the facts in the case of *National Bank of Commerce* v. *Downie, supra.* In this case a contractor had made an assignment of claims which it had against the government

to a surety who had posted a bond for performance of this work. The assignment was given to the surety to protect materialmen and others who performed services and furnished materials on this job. Subsequent to the execution and delivery of this assignment the contractor gave a power of attorney to Martin to collect the moneys owing from the government which was given as security for moneys advanced by Martin. Martin took the power of attorney with knowledge of the prior assignment to the surety. *The litigation arose after the government had made payment of the moneys owing to the contractor, to Martin.*

The court pointed out that since the moneys had already been paid by the government, it no longer was concerned with the validity or invalidity of the assignment. The court did not expressly or impliedly overrule its decision in the case of *National Bank of Commerce against Downie, supra.* It merely pointed out that since the statute was enacted for the benefit of the government, the government no longer had any concern with the matter once it had paid out the moneys. It pointed out that as between the parties to the assignment, there might arise an equitable claim *after the moneys had come into the possession of the assignor.* The court said as follows, at page 597:

> "After payments have been collected and are in the hands of the contractor or subsequent payee with notice, assignments may be heeded, at all events in equity, if they will not frustrate the ends to which the prohibition was directed. See Lay v. Lay, 248 U. S. 24 affg. 118 Miss. 549; 79 So. 291. * * * *An assignment ineffective at law may none the less amount to the creation of an equitable lien when the matter of the assignment has been reduced to possession and is in the hands of the assignor or of persons claiming under him with notice.* (Citing cases)" (Italics mine.)

The Court distinguished *National Bank of Commerce* v. *Downie, supra,* at page 596:

> "Thus in National Bank of Commerce v. Downie, supra, to give a single illustration, where the controversy was between the trustee in bankruptcy of the contractor and prior assignees, the claims against the Government which were the subject of the assignment had never been allowed, much less collected, although the decision cannot be said to have been put on that ground."

The next case that came before this Court was *McKenzie* v. *The Irving Trust Company,* 323 U. S. 365, 65 S. Ct. 405. The decision of this Court in this case was based entirely upon its finding that payment had been made four months prior to the filing of the petition in bankruptcy and therefore no preference had been created. The assignment in this case was made to a bank and therefore came within the exception contained in the statute, except that the bank had failed to comply with the formalities provided for in the statute. Mr. Justice Lehman in a decision rendered by the Court of Appeals of the State of New York in the same case, 292 N. Y. 347, 353, said as follows:

> "The assignment delivered by the bankrupt on November 22, 1940 would undoubtedly have been 'absolutely null and void' if the statute had not been amended on October 9, 1940 for the express purpose of authorizing, subject to conditions therein specified, the assignment of claims against the United States arising even under contracts theretofore made with the Government."

It is important to note that in *McKenzie* v. *Irving Trust Company, supra,* the litigation arose *after payment had been made by the Government.* The Court said at page 369:

> "Here, the payment having been made to the contractor and by it delivered to respondent before the

assignment was perfected, the Government's obligation was discharged; and the situation was no different than it would have been if no assignment had been made."

In the case of *M. M. Landy Inc.* v. *Nicholas*, 221 F. (2) 923, the litigation arose after warrants had been issued, the Court said as follows:

"The cases of National Bank of Commerce of Seattle v. Downie, 218 U. S. 345, 31 S. Ct. 89, 54 L. Ed. 1065 and Spoffard v. Kirk, 97 U. S. 484, 24 L. Ed. 1032, which said that such an assignment was of no effect and unenforceable even between the parties thereto, have never been expressly overruled, although Martin v. National Surety Company, 300 U. S. 588, 57 S. Ct. 531, 81 L. Ed. 822, distinguishing Downie on the ground that there payment had not been made by the Government at the time the assignee sought to enforce the assignment, reached a result quite inconsistent with the *ratio dicidendi* in Downie." * * * *.

In a case decided in the Supreme Court of the State of New York where payment had not been made by the Government, the Court held the assignment void. In the case of *Rodd* v. *Kamen Products Co. Inc.*, 275 App. Div. 855, 89 N. Y. Supp. 2d 406, the Court said as follows:

"The assignment delivered to plaintiff was void. Manhattan Commercial Co. v. Paul, 216 N. Y. 481, 111 N. E. 76; Martin v. National Surety Co., 300 U. S. 588, 57 S. Ct. 531, 81 L. Ed. 822; McKenzie v. Irving Trust Co., 292 N. Y. 347, 55 N. E. 2d 192. It was not executed in accordance with Federal Law. U. S. Code, Tit. 31 Sec. 203, 31 U.S.C.A. Sec. 203, U. S. Rev. Stat. Sec. 3477. No warrant for payment had issued and payment thereunder had not been made. The United States was a creditor of the corporation. The assignment had no present value and, therefore, could not

work a discharge of the notes. Wise v. Chase, 44 N. Y. 337, 340. At best it was a conditional payment of the notes. Cherey v. McLaughlin, 245 N. Y. 616, 157 N. E. 881. It would become effective only if and when the United States issued its warrant and made payment of the over-assessment of income taxes. * * *"

The rationale of the cases cited seems to be, that as between the parties to an assignment of a claim against the Government; the validity or invalidity thereof will depend upon whether the claim against the Government were allowed and paid at the time the litigation arose or even as indicated in the New York decisions cited above, at the time of the decision. An assignment of a claim against the Government which has not been allowed, its amount ascertained and a warrant issued for its payment passes nothing to the assignee. It is not until the amount of the claim has been ascertained, allowed by the Government and a warrant issued for its payment that the Courts have held that some rights were transferred by the assignment whether they be legal or equitable.

The decision of the United States Court of Appeals in this case is in accord with the prior decisions of this court, of the United States Court of Appeals for the Second Circuit and of the decisions in other circuits.

The petitioner has cited the cases of the *Bank of California* v. *Commissioner of Internal Revenue* (C. A. 9) F. 2d 428, and the *California Bank* v. *The U. S. Fidelity & Guaranty Co.* (C. A. 9) 129 F. 2d 751, as being in conflict with the decision of the United States Court of Appeals in this case.

The case of the *Bank of California* v. *Commissioner of Internal Revenue, supra,* involved the question of fixing the value of a claim for the refund of taxes paid by a decedent. The question involved, was, whether this claim should be valued for estate tax purposes, prior to its

allowance. The estate contended that since the claim was not assignable by virtue of Section 203, Title 31, U.S.C.A., it had no value for tax purposes. The Court held, that regardless of the assignability or lack of assignability of this claim it had a value for estate tax purposes. In deciding this case, the Court stated the general rule, that Section 203, Title 31, U.S.C.A. was enacted for the benefit of the Government. This decision is not in conflict with the decision of the United States Court of Appeals in this case.

The case of *California Bank* v. *U. S. Fidelity & Guaranty Co., supra,* involved the question of the equities between an assignee of a claim against the Government and a creditor of the claimant who received payment from the claimant without knowledge of the prior assignment. The Court held that the creditor was entitled to retain the monies that it had received since it had received the same without notice of the prior assignment.

It should be noted that this case involved the rights of the parties *after* the monies had been paid out by the Government. This case is not in conflict with the decision of the United States Court of Appeals in this case.

Judge Weinfeld in his decision in the District Court rightly compared an assignment of claim which had not been allowed, to an assignment of a liquor license refund. In the so-called "liquor license cases" the Courts of New York have held that the assignment of a refund due on a liquor license transfers nothing, until the license has been surrendered and the fund has come into existence. It has been held in these cases that an intervening creditor who levies upon the refund is superior to the rights of the assignee even though the assignment was made prior thereto. See, *Atlas Advertising Agency, Inc.* v. *The Casa Cubana Inc.*, 259 App. Div. 951, 19 N.Y.S. 2d 900; *Aecher Realty Corp.* v. *Meredith Restaurant, Inc.*, 256 App. Div. 853, 8 N. Y. 2d 733. See also, *In Re Silver Cup Bar & Grill Inc.*, S.D.N.Y. 50 F. Supp. 528.

In an assignment of a claim against the Government there is no fund in existence nor is there anything to assign until, as directed by the statute, "after the allowance of such a claim, the ascertainment of the amount due, and the issue of a warrant for the payment thereof".

The assignment which was made by the bankrupt in this case to Kraditor and Haber on August 2, 1954 was an assignment of a fund not in existence. At the time of the filing of the amended petition in bankruptcy and up to the present time, this fund has not yet come into existence. It has not been ascertained, allowed or a warrant issued for its payment.

This assignment was therefore not perfected at the time of the filing of the amended petition in bankruptcy and therefore is deemed to have been perfected immediately prior thereto and within four months of the filing thereof.

Section 3 of the Bankruptcy Act provides:

> "a. Acts of bankruptcy by a person shall consist of his having * * * (2) made or suffered a preferential transfer as defined in subdivision a of Section 60 of this Act * * *.
>
> "b. A petition may be filed against a person within four months after the commission of an act of bankruptcy. * * * and such time with respect to the second act of bankruptcy shall not expire until four months after the date when the transfer became perfected as prescribed in subdivision a of Section 60 of this Act."

Section 60a(2) defines perfection of transfer as follows:

> "For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or

equitable proceedings on a single contract could become superior to the rights of the transferee. * * * if any transfer * * * is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before filing of the petition."

The determination of when the assignment was perfected defends upon state law. *In Re Morasco*, 2 Cir. 233 F. 2d 11, 13.

The cases decided in the State of New York hold that an assignment of a fund not yet in existence creates an equitable assignment but if the fund should come into existence within four months prior to the filing of the petition in bankruptcy, the right of the assignee would be subordinate to the rights of creditors.

In re Modell, 2 Cir., 71 F. 2d 148;
Titusville Iron Co. v. *City of New York*, 207 N. Y. 203;
Zartman v. *First National Bank of Waterloo*, 189 N. Y. 267;
Atlas Advertising Agency, Inc. v. *Casa Cubana, Inc.*, 259 App. Div. 951, 19 N.Y.S. 2d 900;
Okin v. *Isaac Goldman Co.*, 79 F. 2d 317 (C.C.A. 2).

The assignment made when the bankrupt was concededly insolvent, and not perfected up to the time of the filing of the amended petition, constitutes a preferential transfer within four months and an act of bankruptcy.

The petitioner raises the question of the importance of this issue to the business world and intimates that if the decision of the Circuit Court of Appeals is sustained it will vitally affect business transactions. The statute forbidding the assignment of claims against the Government 31

U.S.C.A. 203, contains an exception to its general rule forbidding the assignment of claims. That exception provides as follows:

> "The provisions of the preceding paragraph shall not apply in any case in which the monies due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency: provided . . ."

The business world will therefore not be affected by the decision in this case, since a claimant with a claim against the Government may freely assign and borrow money thereon by transacting his business with a bank, trust company or other financing institution.

Conclusion

The decision of the United States Court of Appeals for the Second Circuit is not in conflict with any decisions in the Second Circuit, the Ninth Circuit or any other Circuits or District Courts, nor is it in conflict with the decisions of this Court.

The business world will not be affected by the decision in this case since the holder of a claim against the United States may assign and transfer the same to a bank and trust company or other financing institution in accordance with the provisions of Section 203, Title 31, U.S.C.A.

WHEREFORE, it is respectfully submitted that the application made by the petitioner for a writ of certiorari to the United States Court of Appeals for the Second Circuit, be denied.

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